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FOR EUR DAS GRAFFY FROM AMBASSADOR TAYLOR

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SUBJECT: UKRAINE: SCENESETTER FOR EUR DAS GRAFFY'S FEB 7-12
VISIT TO KYIV

Classified By: Ambassador for reasons 1.4(a,b,d).

¶1. (C) Summary: Your visit to Ukraine comes at a time when the struggle between President Yushchenko and PM Yanukovych for political dominance and the right to define national security, defense, and foreign policy has intensified. Recent legislation passed by Yanukovych's majority in the Rada (parliament) over presidential objections expands the PM/Cabinet of Ministers' authority at the expense of the presidency. After a period of quiescence, opposition leader Tymoshenko has also thrown her hat back into the ring as an active player, making a tactical alliance with Yanukovych in a strategic bid to force Yushchenko to call early parliamentary elections. Although both the President and PM continue to talk about cooperation, all sides are now waiting for the Constitutional Court to weigh in on myriad questions about how the political system should function.

¶2. (C) In spite of the political maneuvering, the primary gains of the Orange Revolution in societal attitudes, freedom of the press, and foreign and security policy remain intact. The Yanukovych team will be the dominant force for at least the next six months, if not longer, and our goal will be to encourage good policy choices. The Regions-led coalition in the Rada enjoys greater initiative and leverage, not only on economic issues but increasingly in foreign and security policy, formally within the Presidential prerogative to direct. In this latter sphere, progress has been made on WTO accession and relations with Russia, while Ukraine's NATO aspirations have been put on a slower track. End summary and comment.

Regions Takes the Lead

¶3. (C) The dynamic between Yushchenko and Yanukovych, as the institutions of the Presidency and Premiership/Cabinet struggle to define power and influence under the new rules of post-constitutional reform, is one of Ukraine's key political issues. The poorly-written reforms, passed hastily in December 2004 as part of the deal to resolve the Orange Revolution political impasse, have paved the way for the more aggressive team of PM Yanukovych to redefine the political system to its advantage. With a solid Rada majority in hand, PM Yanukovych has moved forward with Party of Regions' agenda, as his Donetsk clan lieutenants took over key economic slots throughout state enterprises and agencies and the Prime Minister has comfortably made statements on Ukraine's foreign and security policies, considered to be constitutionally within Yushchenko's domain.

¶4. (C) A key area of contention has been the fate of Foreign Minister Tarasyuk; under the constitution it is the President's right to nominate the FM, but the lack of

explicit language on dismissing him encouraged the Rada to vote to remove him on December 1. Amidst court battles and accusations, Yushchenko has stood by his FM, while the Yanukovych Government has denied him access to Cabinet meetings, refused to recognize documents he has signed, and starting January 1 refused to fund the Foreign Ministry until Tarasyuk left (note: funding to the MFA was restored January 23 on PM Yanukovych's order after a Tarasyuk-Yanukovych phone call).

15. (C) The most recent effort to tip the balance of power in the Cabinet's favor was the passing of a new Cabinet of Ministers law on January 12, without including any of the suggested inputs from Yushchenko, that gave the CabMin additional inroads on presidential authorities, including cosigning decisions from the National Security and Defense Council (NSDC), putting a time limit on the president's right to name the Foreign and Defense Ministers, after which the Rada coalition could name ministers, and infringing on his right to nominate and dismiss regional governors. The Rada majority, controlled by Yanukovych's Party of Regions, also voted to create a new Deputy Prime Minister in charge of security and law enforcement issues, arguably crossing into another area of presidential prerogative.

Yushchenko Falling Behind

16. (C) Starting in mid-September, Yushchenko belatedly hired more professional managerial types to beef up his Presidential Secretariat. While Yushchenko formally on paper still has more power than the Polish president, there is widespread belief, including among his dwindling supporters, that Yushchenko simply does not have the will to assert himself in a way which would serve the interests of his

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personal political fortunes, the institution of the presidency, and Ukraine in general. He scored a moral victory November 28 in his efforts to shape Ukrainian national consciousness and identity when the Rada voted in favor of his bill on declaring the devastating Stalin-caused 1932-33 famine, known in Ukrainian as the holodomor, as genocide. But such presidential triumphs have been rare.

17. (C) Deputy Head of the Presidential Administration Yatsenyuk told the Ambassador that only when Yushchenko has something that Yanukovych wants does he prevail in the ongoing power struggle. For example, in mid-December, with Yushchenko threatening a second veto of the budget, he finally saw progress on some of his demands, including Rada approval of increases in the living wage and minimum wage; the Rada's agreement to dismiss SBU Chief Drizhchaniy, per Yushchenko's request; and Regions dropping their protests about his replacing the former governor of Sumy oblast. In addition, the Rada and Cabinet once again postponed a final decision in the question of the status of Foreign Minister Tarasyuk, though the impending visit of Putin may have been the primary factor rather than any domestic quid-pro-quo.

18. (C) The December compromise, as with others before it, was short-lived. The January 12 events undid most cooperation and trust between the two executives, with Yushchenko left holding the short straw. In addition, the Rada appears prepared to move ahead with replacing Tarasyuk when it reconvenes in February, with or without presidential agreement.

Opposition Looking for Role

19. (C) Opposition leader Tymoshenko, who had grown frustrated and marginalized in the fall, according to members of her party, took center stage again in January when her faction twice provided the decisive votes to override presidential vetoes. Although this publicly brought into question her

policy agenda, she privately assured us that this was a tactical strategy and wake-up call for Yushchenko. Although Yushchenko's Our Ukraine faction went into opposition in October, there has been little cooperation between the two factions; Tymoshenko told us that the President has avoided most communication with her. Her long-term strategy remains creating a scenario in which Yushchenko can dismiss the Rada and call new elections. Her plan hinges on the Constitutional Court making two key decisions--the first restoring the imperative mandate allowing Rada factions to expel MPs from the Rada for bucking party decisions on votes, without which, she says, a number of BYuT and OU MPs will defect to the Regions-led majority. The second is a decision, she hopes, that will say that the delayed formation of the Yanukovych government in the summer of 2006 was unconstitutional, allowing the Rada to be dismissed for failure to seat a government within 60 days of the previous government's dismissal. Regardless of reasoning, her faction's willingness to deal with Regions increases its importance in the Rada and gives her more leverage over the President, since his vetoes can only stand if BYuT votes to back them.

Economy Healthy Despite Mixed Policies

¶10. (SBU) Yanukovych has been fortunate that Ukraine's economy has performed well since the March 2006 elections. GDP growth reached nearly 7 percent in 2006, on the strength of higher prices for steel (Ukraine's chief export), and increasing consumption spurred by rising social pension and government wage levels. Inflation approached 12 percent, however, as the economy absorbed a near doubling of the price of imported natural gas. Ukraine's external debt levels are low, and the central bank has had little difficulty maintaining a stable currency exchange rate to the dollar.

¶11. (C) Despite Yanukovych's efforts to overcome his image as a creature of former President Kuchma's corrupt crony-capitalist system -- and his laudable success in getting WTO legislation passed -- certain GOU policies perpetuate uncertainty over whether his government promises progress or a return to the old ways of doing business. Among these is the GOU's accumulation of arrears in repaying refunds of VAT proceeds to exporters. Although recent official figures are not available, it is estimated the government owes \$1.5 billion in arrears to businesses. VAT refunds are reportedly available either to well-connected companies, or those willing to pay a "broker" 15 to 20 percent to facilitate the repayment. The government's abrupt

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decision in October 2006 to restrict grain exports--a policy that benefits powerful food industry interests -- has cost exporting firms over \$100 million, and, if quotas are not abolished soon, could cost Ukrainian farmers hundreds of millions more. The GOU's proposals to offer tax privileges only to businesses in certain "special economic zones" justly or unjustly raise fears of corruption or political favoritism.

WTO Plans Moving Forward

¶12. (SBU) The most immediate foreign policy priority for Ukraine remains accession to the WTO. The Yanukovych government initially moved slowly to introduce necessary legislation in the Rada and made some contradictory public statements, raising fears that accession would be delayed. In part spurred by President Yushchenko, however, the GOU made a serious push in October-December, securing parliamentary approval for nineteen separate bills, the bulk of the required legislation. The GOU anticipates having to make some additional legislative fixes to ensure WTO conformity; a law on biotechnology products, currently in the drafting stage, remains outstanding. In addition, Ukrainian negotiators reported progress in negotiations on a bilateral

Market Access Agreement with Kyrgyzstan, the last remaining for Ukraine's accession.

NATO and MAP

¶13. (C) The struggle to define who controls foreign policy has largely focused on the pace of the pursuit of Ukraine's NATO aspirations and the desire by President Yushchenko, FM Tarasyuk, and Minister of Defense Hrytsenko for a Membership Action Plan (MAP) as soon as possible. Yanukovych seized the initiative during his September 14 visit to NATO by stating that Ukraine was not ready for a MAP. Instead, it would focus on practical cooperation with NATO and a strong public education campaign. Yushchenko told Ambassador the day after nominating Yanukovych as Premier in August that he thought he had Yanukovych's agreement to send a positive signal to NATO in August regarding MAP; once in office, Yanukovych declined to do so and moved the terms of the debate in a different direction.

¶14. (C) In terms of gaining wide political consensus outside the Communists about the need to move forward on relations with NATO, and reaching out to Regions' blue base in the east and the south, having Regions leading the government rather than in angry opposition to an orange coalition makes the public education effort on NATO potentially more likely to succeed. In private, Yanukovych has told us that the end goal of membership is not in doubt, but he and Yushchenko differ on tactics; Yushchenko and FM Tarasyuk have repeatedly said the same in public.

¶15. (C) At the same time, Yushchenko is being pushed by anti-NATO proponents to hold a referendum on membership this year. Given the current lack of public support for NATO (roughly 25 percent), such a vote is destined to fail. The law on referenda says that a failed referendum cannot be held again for five years, which would effectively hamstring any significant move towards the Alliance for the rest of Yushchenko's term in office (2009). The CEC and Presidential Secretariat have told us that they are looking for ways to

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postpone the vote, and even Yanukovych has said publicly that it is too soon to make this decision, but legal requirements and a public campaign by minor political parties with ties to Moscow will continue to put pressure on Yushchenko to act. (Note: the most prominent and vocal figure within PM Yanukovych's Regions party in favor of the referendum and against relations with NATO, MP Yevhen Kushnaryov, died January 16 as a result of a hunting accident. It is still too early to predict the full impact of Kushnaryov's unexpected departure from the political stage, but it may lessen pressure on the referendum front.)

Russia: Friendship and Gas

¶16. (C) PM Yanukovych came to office on a campaign promise to improve relations with Russia. Although he has toned down the rhetoric calling for closer ties with Russia, he appears to be seeking the right balance between closer ties to Moscow and protecting Ukrainian sovereignty. Russian President Putin finally visited Kyiv on December 22 for the first time since March 2005. The primary achievements of the trip, Presidential Secretariat deputy head Chaliy told Ambassador, were the positive atmosphere and the launching of the formal

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Yushchenko-Putin Commission mechanism. There were four bilateral agreements signed, the most important being on readmissions and intellectual property protection, but the most contentious bilateral issues, like the Black Sea Fleet, did not appear to be addressed.

¶17. (C) On the energy side, the Yanukovych Government managed

to conclude a positive deal with the Russians soon after coming to power by negotiating a 2007 natural gas price of \$130/tcm, and thus avoiding a repeat of the New Year's Day 2006 gas shut-off. Fuel and Energy Minister Boyko, however, has repeatedly stressed the positive role RosUkrEnergo (RUE) plays in affording Ukraine cheap energy. The non-transparent middleman, which Boyko helped create, expects to expand further its influence in Ukraine's energy market through acquisitions made either by itself or by its subsidiary, UkrHazEnergo.

¶18. (U) Visit Embassy Kyiv's classified website:
www.state.sgov.gov/p/eur/kiev.

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